2001 Country Reports on Economic Policy and Trade Practices
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ISRAEL

Key Economic Indicators

(Billions of U.S. dollars unless otherwise indicated)

	1999	2000	2001 1/
Income, Production and Employment:			
Nominal GDP	102	112	112
Real GDP Growth (pct)	2.3	6.0	0.5
GDP by Sector (estimated):			
Agriculture	1.9	1.9	1.7
Manufacturing	20.3	23.0	21.0
Construction	6.2	6.0	5.0
Services	44.1	49.5	51.0
Government	29.5	31.6	34.1
Per Capita GDP (US$)	16,500	17,700	17,200
Labor Force (000s) 2/	2,345	2,436	2,500
Unemployment Rate (pct) 2/	8.9	8.8	9.0
Money and Prices (annual percentage growth):			
Money Growth (M2) 3/	24.3	20.7	16.0
Consumer Inflation 3/	1.3	0.0	3.0
Exchange Rate (NIS/US$) 2/	4.14	4.08	4.24
Balance of Payments and Trade:			
Total Exports FOB	22.8	28.3	26.8
Exports to United States 4/	10.0	13.0	12.0
Total Imports CIF 5/	30.6	35.2	34.8
Imports from United States 4/	7.7	7.8	8.4
Trade Balance 5/	-7.8	-6.9	-8.0
Balance with United States 4/	2.3	5.2	3.6
External Public Debt (gross)	27.4	27.9	27.7
Fiscal Deficit/GDP (pct)	2.2	0.6	3.6
Current Account Deficit/GDP (pct)	2.6	1.3	2.3
Debt Service Payments/GDP (pct)	4.1	3.9	3.9
Gold and Foreign Exchange Reserves 6/	22.4	23.2	23.1
Aid from United States	2.9	2.8	2.7
Aid from All Other Sources	0	0	0

1/ 2000 indicators estimated using partial-year data.

2/ Annual average.
3/ December to December.
4/ U.S. Department of Commerce figures.
5/ Excludes defense imports.
6/ At end of year.

1. General Policy Framework

Israel is an open economy, with world class firms in such sectors as telecommunications, software, pharmaceuticals, and biomedical equipment. The global high-technology downturn, however, combined with lower exports to the U.S. market and the continuing violence in the region, led to an economic slowdown in 2001. Real growth is expected to be well under one percent and per capita GDP will decline.

The inflation-adjusted central government budget deficit for 2001 will be substantially higher than the target of 1.75 percent of GDP, due to lower than expected GDP growth. The government increased its deficit target for 2002 to 2.4 percent of GDP because of continued weak economic growth prospects and the need to increase spending to stimulate the economy. The outbreak of violence in the West Bank, Gaza and parts of Israel that began in late 2000 has led to substantially increased security costs. Those costs were absorbed within the 2001 budget by cutting spending in most non-security areas. The 2002 budget includes a substantial increase in defense spending, a break with recent trends, which has seen the defense share of the budget steadily decrease in the last decade.

The Bank of Israel has brought interest rates down very cautiously and gradually over the past two years from over 11 percent at the end of 1999 to 6.3 percent by September 2001. Inflation has remained low throughout this period. The inflation rate in 2001 is expected to fall at or below three percent. The inflation rate in 2000 was precisely zero, the lowest level of inflation in the history of the State of Israel. Israel's official inflation target for 2002 is two to three percent. The Israeli shekel, which remained relatively stable throughout 2000 and 2001, weakened somewhat in late 2001, due to concern about the security situation and a lower flow of foreign investments into the country.

2. *Exchange Rate Policy*

The shekel floats within a predefined target zone against a basket of currencies: the dollar, yen, euro, and pound sterling. As a matter of policy, the Bank of Israel does not intervene in the foreign exchange markets as long as the shekel remains within the target zone, although it is obligated to do so once the limits of the zone are reached. Israel has ended almost all of its remaining capital controls, except for limits on Israeli institutions' foreign investments.

3. Structural Policies

Over the past decade, Israel has gradually reduced the degree of government involvement in and control over the economy while increasing the influence of domestic and international competition. Israel signed a Free Trade Agreement with the United States in 1985 and has similar agreements with the EU, the EFTA, Mexico, and other countries. The Government of Israel is planning to privatize the Bezeq telephone company in 2002, and also plans to privatize the state shipping company, Zim. The government continues efforts to increase competition in the telecommunications sector. Competition already exists in international long distance services, and is expanding to include wireless broadband and internet services. In 2001, the Israel revised its law to permit cable television companies to provide telecommunications and internet services.

The discovery of commercial quantities of natural gas in Israeli waters and an Egyptian agreement to sell natural gas to Israel are causing changes in Israeli energy and regulatory policies. The government must address production, transportation, and pricing issues, as well as the security and political implications of the agreement with Egypt. The state power company, Israel Electric (IEC), dominates electricity generation and distribution. There has been little progress toward opening the electricity market to competition.

Taxes in Israel remain high, with marginal tax rates (including payments for social security insurance) reaching 60 percent. The government tried, but failed, to push through a far-reaching income tax reform package in 2000 that would have eliminated most exemptions and lowered marginal rates. Instead, the government has focused on some targeted changes in tax policy. In mid-2000, purchase taxes were eliminated or reduced on more than 600 items, including imported products like color televisions, refrigerators, VCRs, dishwashers and cosmetics. In September 2001 the government decided to exempt foreigners investing in Israeli venture capital firms from taxes for at least the next two years. This policy is scheduled to be reviewed in January 2004.

4. Debt Management Policies

Israel's total gross foreign debt (including both public and private debt) was $66 billion in mid-2001. After netting out foreign assets of $61.2 billion, the country's net external debt was $4.8 billion in mid 2001.

5. Significant Barriers to U.S. Exports

With the exception of some categories of agricultural products and processed foods, by 1995 all duties on products from the United States were eliminated under the 1985 United States-Israel Free Trade Area Agreement (FTAA). In 1996, the United States and Israel agreed on a five-year program of agricultural market liberalization, which provided for increased access during each year of the agreement via tariff rate quotas (TRQ) and tariff reductions. In renegotiating this agreement in 2001, the U.S. government seeks improvements that would permit more efficient access to Israeli markets for U.S. products.

Despite some reductions, Israel still charges a purchase tax on many goods, both imported and domestically produced. The tax applies to automobiles, many automobile parts and accessories, fuel, alcoholic spirits, cosmetics, and other products.

The Israeli government decided in August 1999 that official Israeli standards could incorporate, in their entirety, more than one foreign standard. The Government of Israel has been slow to implement this policy, however, which has caused difficulties for some U.S. manufacturers. Enforcement of mandatory standards on domestic producers can be spotty. Israel has agreed to notify the United States of proposed new mandatory standards to be recorded under the WTO.

Israel actively solicits foreign investment, including in the form of joint ventures, and especially in industries based on exports, tourism, and high technology. Foreign firms are accorded national treatment in terms of taxation and labor relations and are eligible for incentives for investments in priority development zones after receiving the approval of the Ministry of Industry and Trade. In September 2001, the Ministry of Finance announced that foreign investors in Israeli venture capital firms would be exempt from capital gains taxes. This is a temporary measure scheduled to be reviewed in 2004. There are generally no restrictions on foreign ownership, but a foreign-owned entity must be registered in Israel. Profits, dividends, and rents can generally be repatriated without difficulty through a licensed bank. Investment in regulated sectors, including banking, insurance, and defense-related industries requires prior government approval.

Israel has one free trade zone in the city of Eilat. In addition, there are three free ports: Haifa, Ashdod, and Eilat. Enterprises in these areas may qualify for special tax benefits and are exempt from indirect taxation.

Israel is a member of the WTO and strongly supports the rules-based, multilateral trading system. In addition to its other WTO obligations, Israel is one of only 28 signatories to the WTO Government Procurement Agreement (GPA), one of the two “plurilateral” agreements developed by the WTO. (Israel is not a part to the plurilateral agreement on Trade in Civil Aircraft.) The GPA is intended to provide for more transparent and predictable international tendering procedures for a wide range of government entities. In signing the GPA, Israel retained the right to require offsets of up to 35 percent through 2000 with a reduction to 20 percent by the year 2004. The use of offsets will be subject to further negotiation with GPA member countries after the level has reached 20 percent. The offsets are subcontracts to Israeli firms that are specified in an industrial cooperation agreement between a contracting company and a government entity. They may involve investment, co-development, co-production, subcontracting, or purchases from Israeli industry.

Some Israeli government entities notify the U.S. government of tenders valued at over $50,000 but many do not, and the notices that are received frequently carry short deadlines and are often only in Hebrew. Complex technical specifications and kosher certification requirements discourage foreign participation in government tenders for food.

Israeli law provides for a 15 percent cost preference to domestic suppliers in many public procurement purchases, although the statute recognizes the primacy of Israel's bilateral and multilateral procurement commitments. The cost preference for local suppliers can reach as high as 30 percent for firms located in Israel's priority development areas.

6. Export Subsidy Policies

Israel has eliminated virtually all of its export subsidy programs. It retains a mechanism to extend long-term export credits, but the volumes involved are small, roughly $250 million. Israel has been a member of the WTO/GATT Subsidies Code since 1985.

7. Protection of U.S. Intellectual Property

Israel's legal system provides for protection of IPR, but enforcement of IPR laws is not adequate. The U.S. Trade Representative placed Israel on the "Special 301" Priority Watch List again in 2001 because of continuing illegal copying and sale of pirated music and software CDs. USTR noted that Israel has demonstrated that it is serious about addressing piracy, but it needs to increase resources and personnel to bring about adequate prosecution and prosecution of IPR crimes. USTR also expressed concern that Israel permits generic pharmaceutical manufacturers to obtain marketing approval for generic products based on confidential test data submitted by innovator pharmaceutical firms, which may be a violation of Israel's commitments under the WTO Trade Related Aspects of Intellectual Property (TRIPS) agreement.

On the positive side, Israeli Customs has increased its seizures of counterfeit goods entering Israel. The Israeli government is working on revisions to its copyright law that would make it easier for Israeli prosecutors to bring charges against copyright violators.

Israel is a member of the World Intellectual Property Organization (WIPO), and is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Paris Convention for the Protection of Industrial Property, and the Patent Cooperation Treaty. Israel is also a member of the International Center for the Settlement of Investment Disputes (ICSID) and the New York Convention of 1958 on the recognition and enforcement of foreign arbitral awards.

8. Worker Rights

a. *The Right of Association:* Israeli workers may freely join established organizations of their choosing. Most unions belong to the General Federation of Labor (Histadrut) and are independent of the government. Histadrut's membership dropped sharply in the mid-nineties after the federation's links with the nation's largest health care fund were severed. A majority of the workforce remains covered by Histadrut's collective bargaining agreements. Non-Israeli workers, including nonresident Palestinians from the West Bank and Gaza who work legally in Israel, are not members of Israeli trade unions but are entitled to some protection in organized workplaces. The right to strike is exercised often. Unions freely exercise their right to form federations and affiliate internationally.

b. *The Right to Organize and Bargain Collectively*: Israelis fully exercise their legal right to organize and bargain collectively. While there is no law specifically prohibiting antiunion discrimination, the Basic (i.e., quasi-constitutional) Law against discrimination could be cited to contest discrimination based on union membership. There are currently no export processing zones, although the free processing zones authorized since 1994 would limit workers' collective bargaining and minimum wage rights.

c. *Prohibition of Forced or Compulsory Labor:* Israeli law prohibits forced or compulsory labor for both Israeli citizens and noncitizens working in Israel.

d. *Minimum Age for Employment of Children:* Children who have attained the age of 15 and who remain obligated to attend school may not be employed, unless they work as apprentices under the terms of the apprenticeship law. Nonetheless, children who have reached the age of 14 may be employed during official school holidays. The employment of children age 16 to 18 is limited to ensure adequate time for rest and education. Ministry of Labor inspectors are responsible for enforcing these restrictions, but children's rights advocates contend that enforcement is unsatisfactory, especially in smaller, unorganized workplaces. Illegal employment of children does exist, mainly concentrated in urban, light industrial areas.

e. *Acceptable Conditions of Work:* The minimum wage is set by law at 47.5 percent of the average national wage, updated periodically for changes in the average wage and in the consumer price index. Union officials have expressed concern over enforcement of minimum wage regulations, particularly with respect to employers of illegal nonresident workers. Along with union representatives, the Labor Inspection Service enforces labor, health, and safety standards in the workplace. By law, the maximum hours of work at regular pay are 47 hours per week (eight hours per day and seven hours before the weekly rest). The weekly rest must be at least 36 consecutive hours and include the Sabbath. Palestinians working in Israel are covered by the law and by collective bargaining agreements that cover Israeli workers.

f. *Rights in Sectors with U.S. Investment:* Worker rights in sectors of the economy in which U.S. companies have invested are the same as described above.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount

Petroleum		4
Total Manufacturing		2,326
Food & Kindred Products	79	
Chemicals & Allied Products	5	
Primary & Fabricated Metals	-2	
Industrial Machinery and Equipment	95	
Electric & Electronic Equipment	1,827	
Transportation Equipment	7	
Other Manufacturing	315	
Wholesale Trade		74
Banking		0
Finance/Insurance/Real Estate		236
Services		558
Other Industries		197
TOTAL ALL INDUSTRIES		3,426

Source: U.S. Department of Commerce, Bureau of Economic Analysis.